

USAID SERBIA ENTERPRISE DEVELOPMENT PROJECT
Annual Project Summary and Report – July 2004 through June 2005

Date: August 23, 2005

To: Ms. Aleksandra Zoric Krzic, Economic Policy and Finance Office, USAID/SCG (Serbia and Montenegro)

From: Dr. Andrew Vonnegut, Chief of Party, Booz Allen Hamilton

Re: Annual Project Summary and Report – July 2004 through June 2005

CC: Ms. Maja Piscevic, Senior Legal Advisor, USAID/SCG (Serbia and Montenegro)
Mr. Tom Olson, Director, Economic Policy and Finance Office USAID/SCG
Dr. Yoon Lee, SEGIR GBTI CTO, USAID/DC
Ms. Maureen Shauket, RCO, USAID/Budapest
Dr. Miroljub Labus, Deputy Prime Minister
Mr. Velimir Gavrilovic, MIER
Mr. Vlatko Sekulovic, MIER

1. Project Identification

Title: USAID Serbia Enterprise Development Project
Contractor: Booz Allen Hamilton Inc. with ACDI/VOCA, IESC, and Mendez England & Associates
Contract Number: PCE-I-00-98-00013-00
Task Order No.: 814

2. Project Performance Dates

Period of Performance: July 1, 2003 - June 30, 2006
Start Date: July 1, 2003
Report Date and Number: July 27, 2004, No. 12
Anticipated Completion Date: June 30, 2006

3. Key Advisors:

Andrew Vonnegut, Nenad Popadic, Ana Ilic, Ana Djordjevic, Stevan Todorovic, Marina Jovanovic, Jelena Sevo, David Cowles, Don Pressley, Chris Williams, Remer Lane, Timothy Collins

Contents

I. Introduction.....	1
Tangible Results are Growing.....	1
Methodology	2
II. Policy and Institutional Development	3
Progress Against Prior Year Work Plan.....	3
Strategies for the Final Year	4
Expected Impact.....	5
III. Sector-Level Work	6
Progress Against Prior Year Workplan: Overview	6
Fruit: Strategies, Activities, and Results	7
Apparel: Strategy, Activities, and Results	8
Furniture: Strategy, Activities, and Results	10
Information and Communications Technology (ICT): Strategy, Activities, and Results	10
Pharmaceutical Research: Strategy, Activities, and Results	12
Tourism: Strategy, Activities, and Results.....	14
IV: Grant Program	16
VI: Conclusions and Performance Risk Factors	19
Appendix I: SEDP Sector Support Organization Chart	20
Appendix II: Locations of Grant Activities	21

I. Introduction

Through implementation of SEDP, Booz Allen Hamilton is improving Serbian companies' ability to access and service competitive, mainly international, markets. SEDP recognizes that companies that are not selling into secure and growing markets do not add employment or contribute to economic growth.

Project activities strike a balance between immediate results in exports and employment, and building long-term foundations. The SEDP monitoring and evaluation database has documented and validated new markets for Serbian companies and millions of dollars in increased exports due directly to SEDP activities. The core of the project, however, is the permanent addressing of the fundamental gaps that keep Serbian companies from being more competitive. In each sector SEDP has programs in place to do so.

Tangible Results are Growing

Though sectoral change can take time, SEDP's efforts are beginning to show strong and measurable results at the company level. Some highlights include:

- Apparel maker Ivkovic has sold its entire annual production and received financing to expand as a direct result of SEDP. The company now is responding to offers from Nordstrom's and other major retail chains.
- After heavily promoting Serbia to the international travel industry and in international media such as BBC, Travel Channel, and the *Guardian*, SEDP is now seeing results almost unprecedented in the industry. Lonely Planet has named Serbia one of the top 20 travel hotspots for 2005. The London *Observer* has hailed Serbia as the "next big thing." Tourism now leads as one of the fastest-growing sectors of the Serbian economy.
- Juice maker Nectar is now the fastest-growing juice company in Europe, with exports to Singapore and the greater region. Raspberry juice, developed by the company Fresh&Co. with SEDP consultation, received the World Juice Award for best new product worldwide for 2004. For the first time ever, SEDP initiated lucrative fresh wild mushroom sales to the U.S.
- Serbian food products were a hit at a recent New York trade show. In one of the world's most competitive markets, the SEDP-supported Serbian exhibitors earned nearly \$2 million in contracts during the first two weeks after the show. These results, the product of meticulous preparation, buyer contacts, and follow-up, far exceed those from any other donor-supported trade show exhibit for the sector.
- In pharmaceutical research, the number of international contract research organizations investing in Serbian offices has increased from three in 2004 to 10 in the first half of 2005. Major international companies such as U.S.-based Pfizer have come to Serbia, driving the total number of trials up more than 50 percent year-on-year. SEDP capacity-building and promotional activities have been instrumental in achieving these results.
- ICT companies working with SEDP have entered promising new contracts. These include one company's three-year development and maintenance contract with an ING subsidiary in the Netherlands, and another's contract to supply a digital radiology system to a leading Swiss company. The surge in Serbia's international profile and reputation recently attracted interest from Yahoo! A representative from the firm met with SEDP clients and staff to explore bringing the first major offshore development center to Serbia.

SEDP's ultimate goal is to leave behind stronger sectors, well-positioned for the future with contacts to markets and the means to use them. As a result of SEDP efforts, companies are making better products, offering better services, and getting those to the right customers. Serbia is emerging as a global contender in fruit products, tourism, and niche apparel. The country is developing an international reputation for quality. This has become a matter of national pride, reflected in media coverage even in traditionally opposition media, and has given many businesspeople and citizens a new perspective on Serbia's place in the European and world economy.

The potential for projecting SEDP success to a broader range of companies is significant. Based on experience and results, continued support to the right sectors could accelerate Serbia's integration with world markets by many years. Continued support for this process may have profound implications for Serbia's social and economic stability.

Methodology

Booz Allen believes that the SEDP methodology works. It is not based on popular theories or principles that reduce easily to sound bites, but on a relentless focus on markets, attention to incentives, careful analysis, and a lot of expertise and work. Some broad themes of SEDP's methodology include:

- Dispensing with ideas of creating clusters as definable entities, and focusing on broad sectoral capacities and dynamics. There is no search for quick fixes, only long-term solutions.
- Constant contact with and feedback from all participants in the sectors, searching for the best leverage points and workable solutions. The program focuses on what sectors need and will respond to, not on implementing arcane theories. All solutions are aligned with incentives and political realities.
- A relentless focus on the market and what the market wants. Any activities that cannot be shown to move companies successfully toward the market to generate revenue and jobs are dropped.
- Attention to both existing and future product mixes. The former has more immediate employment and export effects, the latter long-term growth and competitiveness effects.
- Pursuit of long-term, self-sustaining impact. Most short-term assistance is limited in effect. To the extent possible, new knowledge is imbedded in university curricula, business or trade associations, and/or business service provider (BSP) capabilities.
- Entrepreneurial, opportunistic, and creative solution development. This reflects an aversion to textbook solutions and a recognition of the complexity of each environment.
- Detailed work plans and constant review of strategy and tactics. All activities and actions are systematically and repeatedly questioned in light of the above.

The overall theme is to drive real, permanent, documented, and competitiveness-increasing changes in each sector.

Note that this annual report is an update on the 2004 report. As such, it does not include many of the basic strategies and organizational descriptions that would make it complete on its own. Readers who have not read the 2004 report should do so to fully understand the project.

II. Policy and Institutional Development

Progress Against Prior Year Work Plan

With the lack of progress on the National Competitiveness Council (NCC), SEDP began to seek ways to carry out the functions of the NCC while using existing institutions. In year two, activities at SEDP centered around both advocacy and improving communications with potential international investors and buyers. These were to be two of the main functions of the NCC. The background, strategy, and rationale for SEDP's approach are covered in the previous annual report and will not be repeated here.

On advocacy SEDP works on two fronts: with the main business associations on broad economic issues, and with sector-level groups addressing policies that are particular to those sectors. In both areas, the emphasis is on the particular pressing needs and barriers as identified by the different groups, not on broad policy reform. With both groups, SEDP activities follow two tracks: assisting them in developing policy positions, and advocating those positions around topics that they identify as critical, and developing their ongoing capacity to do so. The main goals with the associations are to get them in the habit of consolidating and making consistent their positions, while bringing their collective influence to bear.

Serbian business associations are a mixed lot in terms of both ability and will to undertake advocacy. The most interested and capable are the two with international affiliations, the Foreign Investors Council and the American Chamber of Commerce in Serbia. The purely Serbian organizations have been less interested. The Union of Employers was initially a fairly strong partner, but underwent internal turmoil last year that left its leadership in question. The Union also tends to rely upon its quasi-official position in a tri-partite "social partnership" with the trade unions and the Ministry of Labor. The Union has tended to shy away from taking active positions against the government. The Association of Shareholder Companies also initially participated, but also lost interest in actively pushing a common policy agenda. Both of these two continue to participate, but less actively than before. Other associations, when examined, turned out to either be ephemeral or representing mainly larger monopoly companies.

In many ways, the observed pattern fits well with interest group theory. The marginal costs (time and money) and risks (political complications) of participation are greater than the marginal benefits, given that other groups are taking a more active role. Unfortunately, these basic patterns tend to carry to an extreme in Serbian society. It is not a culture with a high level of cohesiveness and tendency to spontaneously congeal around issues. The classic "free rider" problem is exacerbated by a general feeling that the system cannot change, thereby lowering the perceived benefits of participation.

SEDP was aware of this basic problem from the start, as it is broadly consistent with the reasons for the NCC's failure. It is also consistent with other unsuccessful donor attempts to create broad forums for policy reform such as those promoted by the World Bank and the European Agency for Reconstruction (EAR). It is also why SEDP did not follow that track this year. SEDP believes that the main way to counter this inertia is to show results from efforts, and then build from that basis. Organizations that are not familiar with advocacy and its effects need to see those before they will actively participate and commit resources. Advocacy successes over the last program year are briefly outlined below.

- **Labor Law.** A new Labor Law was proposed to overturn the previous progressive one passed with World Bank assistance in 2001. The 2004 draft law was extremely problematic, with many provisions that would damage the business environment. SEDP organized a coalition of the four main business associations to defeat the new law. The activity was a partial success, both in terms of the removal of some of the worst provisions, and in terms of getting the associations to speak to

the government and the press with one consistent voice. Subsequent debate and amendments were consistent with the content and language of the work done with SEDP support.

- Information and Communications Technology (ICT) "White Paper." The document outlined and gave a rationale for major legislative and regulatory changes, as prioritized by the industry. SEDP worked with industry leaders to present the paper to all relevant government institutions. Over the past year, a majority of the recommendations have been adopted or are moving in that direction. This was a sector-level effort, supplemented by the business associations.
- Game Meat Export. A group of owners of hunting lodges expressed to SEDP the problem of their EU-based clients not being able to bring their game meat home. SEDP initiated a process to certify a group of slaughterhouses to EU standards. This involved working with the lodges to draft a policy brief, lobby the Serbian Government to lobby the EU for certification, select qualified slaughterhouses, and initiate steps toward certification. This effort is particularly relevant as it will result in the first meat processor of any kind to get certification for EU export.
- Universal Protection of Varieties (UPOV). For Serbia to move beyond its reliance on bulk frozen agricultural markets, new varieties must be introduced that are more suitable for fresh markets. SEDP has been working with the industry and the Ministries of Agriculture of Serbia and Montenegro to pass the legislation needed to apply to the international convention on varieties. This is expected to happen this summer.
- Other areas in which SEDP has worked: introducing amendments into the Tourism Law; resolving point of origin issues with apparel; introducing better procedures into the new Law on Drugs, and working to resolve administrative gridlock on registrations; working with the business associations to lobby for changes in the Law on Competition to make it less administratively burdensome; and, helping to resolve burdensome reporting associated with the VAT law and exports to Montenegro.

On communications with investors and buyers, SEDP's primary counterpart is the Serbia Investment and Export Promotion Agency (SIEPA, <http://www.siepa.sr.gov.yu>). SIEPA has a mandate from parliament to represent and promote Serbia in all issues related to foreign investment and exports. SEDP has been working with SIEPA on two main fronts. The first is in improving the image that SIEPA and Serbia project to the outside world. SEDP has provided a series of trainings in public and media relations, including conducting regular desk-side briefings with the Agency head. With intensive and essential SEDP assistance, SIEPA has developed a new logo and related materials, developed a new award-winning website, produced a promotional video, and created a press center.

The second area is in customer relationship management. SEDP has helped SIEPA create a system for maintaining consistency and follow-up in customer relations. Working with SIEPA staff, a SEDP advisor drafted telephone and correspondence templates and protocols and created clear job descriptions. SEDP also provided SIEPA with multiple licenses for the ACT! customer resource management database.

Assistance to SIEPA was put on hold for the first quarter of 2005, due to restrictions placed by the U.S. State Department on working with Serbian central government entities. This precluded SEDP's ability to follow up on several important initiatives, and cooled relations with SIEPA.

Strategies for the Final Year

SEDP work in the coming year is centered upon several areas.

- Bring ongoing advocacy activities to a successful conclusion, including the remaining ICT issues, the export of game meat, and the varieties law and UPOV membership. This is critical both for program success, and to show the benefit of engaging in advocacy.
- Build the capacity of both the business organizations and the sector-level groups to generate new targets for advocacy and continue on their own. The ongoing focus will be in training, policy position development and review, and policy and media advisory support to the groups.
- Re-focus on domestic and sector-level groups. That the two main business organizations are made up of many foreign members is not optimal. Though the American Chamber of Commerce has many Serbian members, a more domestic base is still required.
- Continue to work with all of the groups to build the number of access points to the government. Given that the Serbian government is highly factionalized, only “shuttle lobbying” ensures that the main decision-makers are reached. SEDP will also continue to engage quasi-public institutions such as the Serbian Chamber of Commerce, which have good access to the government.
- Improve overall access to the policy process. Access to the policy process remains complicated. Though many individual offices are now open to business leaders and groups, the overall process by which laws are created and reviewed is often opaque. Certain laws are simply not seen in their final stages prior to submission to parliament. SEDP will work with industry leaders to develop sound means to improve access across government.
- Continue working with SIEPA to build effective communications and customer relationship management capabilities. Though the main components are in place, some follow-up will be required.

Expected Impact

The work completed has led to a number of permanent positive changes in the business environment. Additional successes are expected in the coming year. Activities for the coming year are expected to lead to: better capacity of business organizations to identify and conduct effective advocacy on issues that they believe are important; more access points to the government; a government that is more used to consulting with the private sector; and, improved government communications with potential investors and buyers.

III. Sector-Level Work

Progress Against Prior Year Workplan: Overview

SEDP has development strategies and workplans in place for five of the six sectors in which it works. These will be discussed in more detail below. These strategies and workplans follow the principles outlined in the previous annual report. SEDP has carefully analyzed each sector and considered with the leaders a wide range of activities with both short- and long-term impact. To the extent possible, short-term technical assistance has been built into longer-term capacity building and curriculum development activities. SEDP has also been careful to engage a wide range of players in the design and execution of these activities. These include companies, suppliers, associations, agents and buyers, and multiple levels of government. As a general strategy, SEDP also seeks to work in sectors on two levels: with the existing product mix for more immediate results, and with higher-value areas to better position Serbia in the future.

Taking the above into consideration, SEDP sector lead advisors have developed detailed work plans. The work plans are reviewed, critiqued, and updated in committee every six weeks on a rotating basis. The details of SEDP organization and strategy will not be elaborated on here, as these are outlined in detail in the previous annual report. For reference, Appendix I shows how SEDP is organized and how sector support roles work. There are only two major changes since that time. First, SEDP has failed to make any major gains in the furniture sector and proposes to drop that area of activity. This will be discussed in more detail below. Second, SEDP has added a design component as another “cross-cutting” area to provide support across the sectors.

Design had long been recognized by SEDP as an important differentiator between bulk and high value products. As quality increasingly becomes an assumption for consumers, design then becomes one of the key differentiators. This holds true both in product and packaging, and for both goods and services. Many Serbian products are unable to compete not because of poor quality, but because of outmoded designs that do not appeal to customers. Though there is considerable creative talent in Serbia, designers often are not focused on the market, in particular what customers want, and what will make products sell. Similarly, companies often see design as an adjunct to advertising, rather than a way to create an image around their product and make it more attractive to customers.

With the OSCE and the small UK-based Chartamede Foundation, SEDP carried out a survey of designers and industry and held a roundtable to present the results and plan a way forward. As a result, SEDP is supporting a number of activities. The first is a series of workshops and university curriculum development activities for designers, producers, and design faculty to introduce market concepts into both the supply of and demand for design services. Initial workshops were conducted on labeling and package design by a world-class package designer, and on “graphic design that sells” by an editor of *Vogue* magazine in the UK. The second is a series of networking events to bring together designers and producers. The goals are to raise expectations and demands on the part of companies, while increasing designers’ capacity to respond to market needs. SEDP will also be sponsoring a network, website www.designserbia.org, and series of events to assist designers in better understanding the needs of the marketplace and in better marketing themselves. Finally, the regulatory team will conduct trainings and disseminate information on copyright issues.

Fruit: Strategies, Activities, and Results

- Goals:
1. Differentiate and diversify markets for bulk products
 2. Improve processed goods and exports for retail and food service
 3. Increase production for domestic and international fresh markets

In the fruit sector SEDP is working on three fronts, though lessening activity in one. The first, where SEDP is decreasing activity, is working with the main existing product mix, frozen fruits and bulk products. This is currently the staple of the Serbian fruit export market. Following the period of sanctions, most producers were selling to local and regional traders as price takers. SEDP has been assisting producers in: diversifying their markets; getting timely information on trends in global markets; obtaining needed certifications such as HACCP, organic, and kosher; and, moving into additional value added products such as purees and fillings. SEDP has provided dozens of market contacts directly, as well as hundreds indirectly through its broad trade show and website marketing activities. SEDP maintains the site www.serbianfruit.com, which averages over a thousand unique visitors from around the world each month.

Global market trends indicate that despite these efforts, margins for bulk products will continue to drop. As China and other low-cost producers move into the markets, Serbia needs to move up the value chain in order to maintain and increase farm incomes. There is still much to be done in the bulk foods area. However, SEDP feels that its marginal returns to efforts there are decreasing. Part of this is due to previous successful SEDP market penetration efforts, which many companies are now taking on themselves, thereby multiplying the effects. Also, the Ministry of Agriculture and other projects such as CRDA are now better positioned to provide services such as certifications on a larger scale.

Resava Commerce, with packaging, marketing, and trade show support from SEDP, sold half its next year's production for premium prices to buyers at the 2005 New York Fancy Food show.

SEDP is currently focusing its efforts in two higher-value areas and will continue this during the next year. The first is in processed products for both retail and food service clients. The SEDP program is designed to address each of the improvements companies need to sustainably sell into global processed food markets. The main market push is international, but the new packaging, marketing, negotiations, and sales techniques companies learn will help them compete against imports on domestic markets as well. A number of the companies SEDP is working with were initially assisted by CRDA. SEDP has helped take

them to a new level.

The second area of SEDP effort is implementation of a major strategy with the Ministry of Agriculture to move Serbia away from its current reliance on frozen bulk exports to production of fruits and vegetables for fresh markets. This strategy was conceived of and designed by SEDP, and adopted by the Ministry. Implementation will take a two-tiered approach. SEDP will obtain the necessary technical knowledge through its advisors, which will be packaged into easily disseminated modules. The first tier of knowledge dissemination will be focused intensively on a group of a dozen of the larger cold stores that want to convert some of their capacity to fresh packing and export. Each of these cold stores works with several hundred farmers, who will be brought into their fresh production network using the techniques provided by SEDP.

The second tier of knowledge dissemination will be through the Ministry of Agriculture's extension services and the CRDA projects' association contacts. A full workplan outlining roles and responsibilities has been developed with the Ministry. Implementation of the fresh strategy is a long-term effort. Due to SEDP's limited remaining time, most of its activities will center around getting as much critical information about fresh production and markets as possible out to users. SEDP is also looking for schemes to maintain the dissemination and updating of that information.

Specific SEDP activities in the above areas include:

- HACCP, EurepGAP, ISO, and organic certifications
- Trade fairs in new markets (U.S., Japan, Middle East) and extensive preparation and training, including joint work with SIEPA and the EAR
- Trade contacts (Europe, Middle East, Asia, U.S.), both direct and indirect (i.e., website, media coverage)
- Package design and presentation, and package design curriculum development with faculty, design schools, and business service providers
- Product development and quality control
- Weekly dissemination of information on global markets and trends, and institutionalization of the providing of this information in BSPs
- Logistics
- Development and coordination on execution of national fresh fruit and vegetable strategy with the EU, CRDA, USDA, and other donors
- Fresh market price dissemination through mobile phone text messages and other channels
- Fresh market information and techniques (varieties, growing, harvesting, packaging, quality control, marketing)
- Fresh market communications and education (i.e., the “fresh option”)
- Provision of training and assistance on negotiating
- Assistance in obtaining financing for expansion and export

Results to date include a vast broadening of the markets for Serbian frozen and processed fruits. SEDP has played an instrumental role in early assistance to the main frozen and processed food producers in Serbia. All of the initial HACCP and most organic certifications in Serbia were driven by SEDP. The first organic shipments were also due to SEDP. Many companies are in markets that they otherwise would not have been as a direct result of SEDP efforts. This is well-documented in the SEDP monitoring and evaluation database.

If executed well over the longer term, the SEDP processed and fresh market strategies have the potential to radically change the positioning of Serbian agriculture for the better. Given the time frame of the project, SEDP can only develop the strategy and lay the groundwork.

Apparel: Strategy, Activities, and Results

- Goals:
1. Move away from dependence on low-value contract manufacturing
 2. Move Serbian fashion companies into main international markets

The apparel sector had traditionally been a huge provider of jobs and exports in Serbia. Prior to sanctions, Serbian companies produced garments for a wide range of U.S. and Western European companies. These were mostly conducted on a cut-make-trim (CMT) basis, where the materials are imported and only labor is added before re-export. Though Serbia was able to compete in these markets at the time, it was not high-value work. During the time of the sanctions, the global situation changed radically. With China becoming a major trading powerhouse, mass markets have been swamped with very-low-cost goods. Serbia is no longer able to compete over the long run in this market. Jobs and exports have been dropping and are at serious risk of disappearing entirely.

SEDP is working to reposition the sector into markets it can compete in over the long run, and giving companies the tools to do so. Here also SEDP follows a two-level strategy, working with both the existing product mix and targeting new high-value branded apparel. For the first area, SEDP is working with a group of 60 contract apparel manufacturers to help wean them from the CMT market

and move toward servicing new markets on a “full package” basis. Full package production uses similar core skills to CMT, but adds more value and generates more jobs in-country. Under full package, fabric and trim sourcing, cutting, financing, logistics, and quality control all become the firm’s responsibility. Target markets are also different. Making the transition requires that Serbian companies obtain new capabilities, while playing up competitive advantages such as proximity, skilled labor, small flexible plants, and ease of sourcing from various markets. Each of the areas above are being addressed by the SEDP program. The activity is being carried out in coordination with German donor agency GTZ and the Serbian Chamber of Commerce.

Trikotaza Ivokovic’s SEDP-supported international success in trendy fashions has led the company to raise hundreds of thousands of euros for new equipment, employees, and working capital.

The second level of the strategy is to move Serbian-designed, -branded and -manufactured clothing into international markets under their own labels. This represents the highest-value area in the clothing trade. Demand on the Serbian markets, especially for women’s clothing, is extremely exacting. Consumers demand quality and innovative styling. The sanctions in some ways increased capability as consumers no longer had easy access to Western styles anyway. Many of these companies had not taken exporting seriously until working with SEDP, and none would have approached the U.S. market without the project’s support.

Specific SEDP activities in the above areas include:

- Consultations with companies to improve production efficiency, including training of BSPs to expand work and impact across the sector
- Consultations and training in improving quality control
- Assistance in obtaining financing for expansion and full package services
- Market intelligence and marketing support for obtaining new full package clients
- Provision of equipment and training to teachers in technical schools on cutting-edge computer-aided-design and -manufacturing (CAD-CAM) systems
- U.S. market access for fashion companies, including sourcing, merchandising, sizing, labeling, and contracting with agents
- Customs and logistics support
- Trade show assistance, including matching grants
- Support and advice in contract negotiations
- Promotional materials and promotion, including www.serbianapparel.com
- Communications and marketing training

For the fashion companies, results to date include obtaining agents for distribution for four Serbian fashion apparel companies in the U.S. All companies received initial orders and three are expanding their presence. This is the first time Serbian-branded companies have been in the U.S. SEDP promotional efforts have also led to increased exposure to and orders in European markets. SEDP plans to continue this work and hopes to introduce additional fashion companies into the U.S. and other international markets.

For the contract manufacturing companies, SEDP has begun implementation of the strategy to move toward “full package” contracting. So far this has meant: the development of a sourcing guide for companies; development of financial materials for full-package work; an efficiency improvement program and curriculum and business service provider development; and, the implementation of quality control programs in 17 companies. Once the basic preconditions and knowledge have come into place, SEDP will move the companies aggressively to the market in the spring.

Furniture: Strategy, Activities, and Results

Despite being one of the sectors with which SEDP has worked the longest, furniture has returned the lowest level of results. This is both in terms of process and tangibles. It has been extremely difficult to entice the companies in the sector to get engaged in SEDP activities. There was some momentum following the Cologne fair in 2004, but this was quickly lost. Companies failed to follow up on contacts, and even with SEDP support failed to respond to basic inquiries from potential clients. The sector seems to be subject to a general ennui that is hard to shake. SEDP has tried a number of different tactics and programs, without success. These are documented in the monthly reports.

While Serbia does not have any distinct disadvantages in furniture production, it also does not seem to have any major advantages. The beech wood is fairly common in the region. Craftsmen in other countries who have access to Slovenian oak seem to be more adept at making it into products that consumers want. After the long period of sanctions, few companies in Serbia are now equipped to compete in the mass consumer market. They lack the equipment and scale. The most (or only) successful furniture exporter is a mass production company that received favorable treatment and modern equipment during the Milosevic era. The sector also does not seem to be an area of great investor interest.

Results to date are negligible. A few thousand dollars worth of exports came from the 2004 trip to the Cologne fair, and several export contracts are pending as of this writing. Also, a standards program that SEDP supported with the University of Belgrade has brought wood standards into compliance with those of the EU.

Rather than continue to use project resources on this sector, SEDP recommends dramatically reducing activity there and focusing on the areas where there is a higher probability of success. One supply deal was signed, and there are several potential deals pending, as a result of the 2005 tour of potential importers and retailers in Germany, Belgium, and the Netherlands. SEDP has intensively worked with the companies to bring these to conclusion and will continue to support these and additional export development activities at a low level.

Information and Communications Technology (ICT): Strategy, Activities, and Results

- Goals:
1. Bring project management skills to international levels
 2. Remove competitive barriers in the regulatory environment
 3. Improve companies' access to international markets

The technical skills of Serbian programmers and software engineers is considered to be very high. Technical universities in Serbia have historically been of better quality than those regionally, with graduates competent in all the main platforms. Overall proficiency in English also sets Serbian programmers apart from other competitors in the region. Despite these advantages, there is considerable underutilization of skilled labor in the sector, and little service export work. SEDP and the companies have identified three main gaps that keep firms from doing more export work. Each is being addressed by SEDP activities.

The first barrier to increased exports is in the regulatory environment. The telecom monopoly and the lack of enabling regulations in many areas makes it difficult for companies to know the rules, make plans, and compete. This negatively affects both domestic operations, where regulations are non-existent to nebulous in many areas, and export-focused efforts, due to high telecom user fees. SEDP

has been working intensively with companies to lobby government on a wide range of issues. There have been many successes over the last year, though further implementation actions are required.

The second area where Serbian companies are at a competitive disadvantage is in their project management skills. The Serbian software development environment mainly consists of numerous very small companies operating sporadically in niche markets on small projects. Serbian companies have had trouble tying themselves into larger development projects and competing directly for larger projects. A big part of this weakness results from a lack of training on project management and standards in Serbia. Globally, the main set of standards revolve around the Capability Maturity Model

In the fall of 2005, the main technical universities will begin teaching CMMI, the world standard in software development processes.

Integration (CMMI) developed at Carnegie Mellon Software Engineering Institute. SEDP has taken a two-track approach to bringing the CMMI to Serbia. The first was a set of intensive three-day introductory courses taught to practitioners in the winter of 2004. The second ongoing part is integration of CMMI into the curriculum at the main engineering faculties and management consultancies in Serbia. SEDP is assisting in developing the new curriculum and in training professors both to teach the classes to students, and to act as consultants to companies.

The third gap which SEDP seeks to address is Serbian companies' poor capacity to market themselves to international clients. This is an area that is common to all sectors and where SEDP has put considerable effort. After a long period of isolation, Serbian companies generally approach the market through diaspora contacts or sporadically. Few are versed in marketing or sales techniques. In the ICT sector, SEDP has a multi-pronged approach.

The first is in general sales training. This includes basic techniques and tracking methods for qualifying leads. These trainings provide the core skills companies need. In more specialized areas, SEDP conducts seminars on the use of media in generating publicity at trade shows and in general business communications. At the request of companies, SEDP supports a course on negotiations and managing the international business environment, with an emphasis on what to expect during, and how to prepare for, discussions with international clients.

SEDP has also retained three intermittent consultants to provide companies with a package of services to help them get into markets. Each specializes in a different area. Companies work out specific plans with the consultants with clear responsibilities for action and follow-up. The plans are focused on achieving clear marketing and sales results.

Specific SEDP activities in the above areas include:

- CMMI training, and curriculum and BSP development, with initial training done in coordination with the German government
- Specialized curriculum development for niche markets, including massive parallel processing and FPGA circuits
- ICT "white paper" and advocacy activities
- Solution selling seminars, selling tools, and the implementation of these through firm-level consultancies
- Courses, and curriculum and BSP development on negotiations and managing the international business environment
- Media and communications training
- Web site reviews and critique
- Advisory and grant support on marketing strategy and promotional materials development
- Market intelligence support
- Product development
- Sales contact generation and account management

- Product and service pricing and launching
- Digital animation regional activity
- Development and implementation of strategy to bring an offshore development center to Serbia, including discussions with Yahoo! and Luxoft, Russia's largest software development outsourcing company

Though not part of its mandate, SEDP is involved in designing a project to bring wireless internet access to South Serbia in conjunction with a major international operator.

Progress has been made on the regulatory side. As the telecom company effectively loses its monopoly status and the environment improves, results will be seen. The introduction of CMMI and its principles into Serbia will have an impact on how software is developed. The company-level training, and the related curriculum development with universities and private business service providers, will ensure both short-term and long-term impact.

In the approximately one year since SEDP began its work in this sector, several dozen companies have begun a new drive for markets for their products and services. Some have been assisted more intensively than others. Results are beginning to accumulate in the SEDP monitoring and evaluation database. SEDP efforts that provide ICT companies with communications, marketing, and negotiations training and support universities in their ongoing curriculum development will ensure the building of permanent and self-sustaining capacity in the sector. Other companies have benefited from intensive marketing and sales support, and support for sales trips abroad. The SEDP initiative to attract an offshore development center has so far yielded discussions with two top providers with an interest in Serbia.

Pharmaceutical Research: Strategy, Activities, and Results

- Goals:
1. Make Serbia a center for clinical trials
 2. Make Serbian laboratories a center for outsourcing

The pharmaceutical research industry in Serbia is characterized by a high level of expertise, but a low level of international integration. As with other sectors, SEDP's strategy to address this follows a two-tier approach. The first is helping obtain and implement international clinical trials contracts, while the second is working with Serbian laboratories to help them conduct more outsourcing work. SEDP and leaders in the sector identified two main areas requiring assistance. The first of these two areas was in clinical practices training, and the second related area was in Serbia's image abroad. Activities are currently focused on these two areas.

SEDP activities supporting training in good clinical practices and promotional efforts enticed U.S. pharmaceutical giant Pfizer to conduct research in Serbia.

Despite high levels of medical training, Serbian clinicians were not marketable due to a lack of knowledge of clinical practices. SEDP is currently carrying out two major training programs to address this gap. The first is a good clinical practices (GCP) training and certification program carried out with the Association of Clinical Research Practitioners (ACRP), the leading international association in the field. Those who pass receive both internationally recognized ACRP certification and certification from the Ministry of Health. By the end of the program, approximately 140 doctors and other practitioners will have been trained and certified. More importantly, SEDP has fully

institutionalized the program in the new Drug Agency to ensure that it will continue. With the ACRP and the Drug Agency, SEDP helped develop a full GCP curriculum and program. Two Serbian doctors are currently qualified to teach this course, with two more to be so before the project ends.

The second education-related activity is the training of monitors for clinical trials. Though many companies have an increased interest in carrying out trials in Serbia, the demand for qualified trial monitors is greater than the supply. Through a partnership with a European clinical trials company and a German university, SEDP has trained and internationally certified 70 unemployed medical doctors to become monitors. These monitors are in great demand and are being hired.

With the human resource issues being resolved by the above activities, SEDP is beginning to work through counterparts to promote clinical trials in Serbia. Promotion was put off initially for a few months while, with SEDP support, the government resolved some regulatory issues that would have led to delays in trial registration. The ACRP international certification will put Serbia out in front of its neighbors and will help in countering Serbia's overall poor image. Promotion is being done in conjunction with the ACRP and includes articles on Serbian capabilities, a web site connected to the Ministry of Health, promotional materials, and presence at trade fairs.

The second tier in which SEDP works is with Serbian laboratories, to help them conduct more outsourcing work for foreign laboratories. This activity initially got off to a slow start, as SEDP could not find a qualified pharmaceutical laboratory assessor who would work for USAID rates. Assessments for market opportunities were finally conducted from April to July 2005. Initial indications are very positive, with outsourcing potential initially identified in several areas. The assessments were carried out in conjunction with UK-funded Crown Agents, who can provide good laboratory practices (GLP) training in cases where that is a barrier to conducting business with overseas clients.

Specific SEDP activities in the above areas include:

- Established and developed the relationship with the ACRP for good clinical practices training and certification, building a permanent link with Serbia through the Drug Agency and a local ACRP chapter
- Carrying out sustainable institutionalization of GCP courses through the new Drug Agency, including the training of four certified trainers
- Provision of training and certification in the monitoring of clinical trials
- Advocacy leading to improvement of the Drug Law prior to passage
- Dissemination of ethics committee standards for Serbia
- Promotion of Serbia and individual clinics through various means, including trade shows and consultations with potential major international clients
- Development of a promotional and informative web site for international clients
- Assessment of laboratories for commercial potential
- Marketing of selected laboratory functions to outside buyers and coordination with UK-funded support for GLP

The activities will result in the reintegration of Serbian clinics and laboratories into world markets through high-value service exports. Medical professionals will have additional opportunities to increase their incomes, lessening the brain drain of the past decade. From 2004 to the first half of 2005, the number of contract research organizations (CROs) that have invested in Serbian offices has increased from three to 10. This mirrors an increase of over 50 percent in trials registered with the Serbian authorities year-on-year. SEDP estimates that approximately \$5 million in medicines have entered Serbia free of charge over the past year as a result of these trials.

As the new industry matures, new high-paying jobs are being created in clinics and CROs. The prospect and realization of profitable contracts will increase investments in labs, and bring Serbia back to international standards there as well.

Tourism: Strategy, Activities, and Results

- Goals:
1. Improve Serbia's image as a tourist destination
 2. Make Serbia accessible to a broad range of tourists
 3. Improve products in key areas

Following the removal of sanctions and the end of the wars, Serbia found that the tourism market had changed. An analysis of gaps between where Serbian tourism was and where it needed to be revealed two significant discrepancies. The first was a poor image, as a dangerous and hostile country. The second was that Serbia was directing tourists toward an outmoded product mix, focused on medicinal spas and traditional package tours.

SEDP works both at the broad sector level and on activities designed to increase the quality and volume of tourism in specific areas. On the sector level, SEDP is working on both image and accessibility. Serbia lacks any consistent branding, though this is considered to be a basic foundation of modern tourism promotion. In close conjunction with the Tourism Organization of Serbia (TOS), SEDP is working to create a brand for Serbia that can be used by all promoters to present a consistent and positive image. SEDP has also been working closely with TOS and Serbian companies advising them on promotion, familiarization trips for foreign travel journalists, trade show attendance, web sites (including for TOS), and development of a wide range of materials.

Serbian tourism is also hurt by the difficulty many potential tourists face in obtaining basic information. One year ago, there were no tour guides on Serbia available to foreigners, and no sites to research and book accommodations on-line. These two elements are critical for attracting most modern types of tourists, i.e. those that travel outside of packages. SEDP assisted in the development of two guidebooks, one fully domestic and one which is part of an international series. SEDP is also working with one of the top in-bound travel agents in their development of an on-line accommodations site. Finally, SEDP has been working with the main in-bound operators on their marketing strategies, promotion, and customer service.

Ensuring that product quality reflects promotion is a major ongoing challenge for Serbia. SEDP conducts activities to improve product quality, both on specific topics and geographical regions. Topics include training and a resource library for tour guides, designed to help them transition away from traditional tour guiding and into activities that are in demand in the modern marketplace. SEDP has also developed a product development checklist and tool kit that will be made available to all providers. This helps service providers to systematically self-assess their product, and to make changes to address any shortfalls.

Attending the convention fair IMEX after over a decade of absence, the SEDP-supported Serbia Convention Bureau team is bidding for high profile conventions.

Many of the problems in the tourism sector are structural, and reflect broad shortfalls such as those the above activities are designed to address. However, there is a need to work directly on improving and promoting specific products that can be brought to market. SEDP identified and works in two main product areas. SEDP is working with an industry and government working group to establish a convention bureau. Serbia was the fifth busiest European convention location in the 1980s, though this business has since dropped to almost nothing.

Renovations need to be done, but there are many promising venues.

SEDP worked with the group to develop a comprehensive strategy, business plan, timeline, and budget. The bureau is scheduled to start-up in January 2006. As a precursor, SEDP was also instrumental in Serbia's representation at the IMEX convention fair, the first time Serbia was present since the early 1990s.

The second product area SEDP is working on is developing destinations around two spa towns. They both have spas at the center of them, but have the potential to offer much broader services as well, which is essential to attracting a wider range of tourists. SEDP brought together a group of the main industry and government representatives in each area to work on executing a common strategy. The strategies are designed to improve product quality, increase product range, and effectively promote the destinations.

Specific SEDP activities in the above areas include:

- Full product audit of Serbian tourism potential
- Development of “Brand Serbia,” including brand strategy, detailed research in the target markets, and creative brief
- Trade show and promotional assistance, including materials, website, and press book
- Assistance on two guide books, including one fully domestic one
- Assistance developing accommodations website
- Convention bureau strategy and implementation, and www.serbiaconventionbureau.com
- Return to convention fair IMEX after over a decade
- Program for in-bound operators to service foreign clients
- Destination management strategy and implementation in two spa areas, Vrnjancka Banja and Zlatibor, including quality control, product development, and promotional activities, also in conjunction with the CRDA programs.
- Product development tool kit for service providers
- Update of tour guide training and resource library
- Hotel investment strategy to attract investors

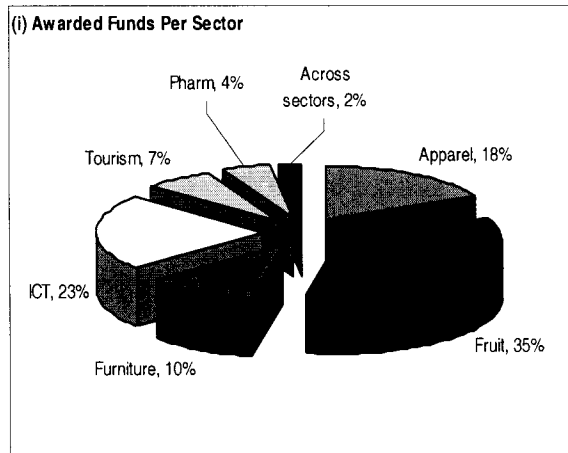
Tourism has been one of the highest-growth areas in the Serbian economy. SEDP efforts, especially in support of TOS, have been instrumental in the change of perception among foreign tour operators and tourists. This has been reiterated in a letter of support from the head of TOS, following a 38 percent increase in revenues in 2004. These results will multiply with initiatives to increase image, access, and product progress. Each of these areas reinforces the other.

Over the coming year, the foundations that SEDP has laid down will yield additional results. A new image and increasing positive feedback will remove many tourists’ inhibitions. A fully functioning convention bureau will begin to attract well-paying visitors in large numbers. The lucrative market of independent tourists will be able to effectively access Serbia for weekend breaks or longer stays in the countryside or at mountain resorts. Finally, older styles of tourist attractions will continue to respond to modern market needs and offer the services that tourists look for.

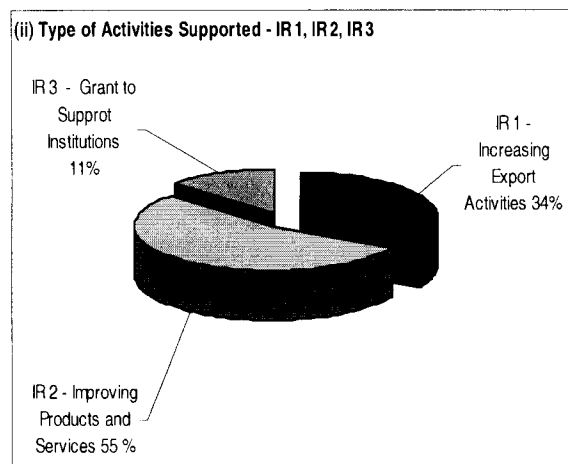
IV: Grant Program

In last year's annual report, the basic principles of the SEDP grant program were laid out, but it is worth reporting on the general direction that the program has taken over the last year. The program is very straightforward. SEDP will reimburse up to 50 percent of expenditures for approved projects. The grant manager and sector leads discuss the program with the companies. The companies then apply, outlining basic company information, business plan, proposed uses of the funds, and expected results. Each month, the grant manager chairs a grant committee meeting where the activities are discussed. The grants are evaluated along strict lines, and must contribute directly to SEDP's tangible results, i.e. exports, employment, and investment.

The grants are a good way to use natural market forces and initiatives within companies to promote SEDP goals. The grant program has prompted many companies to take market risks that they otherwise would not have been able to take. Ideally the grants are bundled with other SEDP activities, such as group trade show visits, training on particular issues, or promotional material development. The geographical dispersion of SEDP grants is given in Appendix II. Note that the grants for Belgrade may indicate simply where the company headquarters is, but not where the actual impact is. Breakdown of dispersion of grants among the sectors are as follows.



Use of grants are as follows:



V: Monitoring and Evaluation

As with many programs of this type, monitoring and evaluation remains a great challenge. The program is designed to make major changes in the way companies in sectors perform. These structural changes consume considerable project resources, but results are difficult to track. This is both because growth from structural and behavioral change often occurs with a significant time lag, and because many companies are affected that are not and cannot be surveyed by SEDP. Successful advocacy initiatives, many trainings, curriculum development, market information, sector-wide promotional activities, and “Brand Serbia” all fit into this latter category. Such activities are critical for changes in sector competitiveness, but do not usually have results that are immediate, easily attributable, or easy to document.

Monitoring and evaluation is also made difficult by SEDP’s approach. The project does not work intensively with small industry groups that some define as “clusters.” In accordance with the original definition of a cluster, SEDP works with a broad and often loose group of companies, suppliers, universities, and government representatives to solve a range of sector-wide problems. Booz Allen believes that such an approach leads to broader and more permanent positive changes in sectors. Without such an approach, projects risk never solving broader problems or ever getting beyond a pilot stage. However, monitoring and evaluation efforts are complicated once the group is expanded outside of a very close and easily monitored group.

In order to address the above issues to the extent possible, SEDP’s monitoring and evaluation system works on four levels.

1. *Sector-level data.* SEDP monitors export, investment, and employment levels in the sectors within which it works. Implementation of the VAT will help increase the accuracy of the data, as more exports will be properly recorded. Data problems do remain, however. Besides normal questions of accuracy, it can be difficult to disaggregate export data into the particular sub-sectors within which SEDP works. Serbia is also facing considerable competitive challenges, and many sectors are losing exports and jobs. It is SEDP’s role to get them to be more competitive, but sometimes only part of a sector can make the transition, especially within the project timeframe. Positive results may get obscured by negative sector-wide results that are beyond the scope of the project.
2. *Company-level data.* SEDP conducts regular surveys on the main companies with which it works. Revenues, exports, and employment figures as well as qualitative data are collected. This data gets closer to measuring real program impact, though companies can be reluctant to release their true figures. Tax evasion and fear of competitors getting the data throw some question on accuracy. The extreme lack of trust endemic to Serbian society also complicates firm-level data collection.
3. *Direct program impact.* This is by far the most reliable set of data. Here SEDP measures and analyzes the direct impact that particular activities of the program have. The impact is then explained, justified, and attributed to SEDP by some percentage. Any figures here are known to be accurate and are fully verifiable. The main problem is that they are incomplete, due to the problems mentioned above. They focus on the results of export development activities, and not long-term structural changes.
4. *Process indicators.* SEDP tracks a wide range of process indicators that can help document project progress and changes in the sectors.

Booz Allen believes that SEDP’s monitoring and evaluation system is one of the best in the industry. However, it still has not been able to fully resolve the problems described above. For example, the

fresh production strategy developed and implemented with the Ministry of Agriculture has the potential to radically change agriculture in Serbia. Similarly, the transition from CMT to “full package” will throw a lifeline to apparel manufacturers that are losing their markets against Asian competitors. Results for these activities and others will only start to appear toward the very end of the project, if at all during the project’s period of performance. Along another line, TOS states SEDP support has been instrumental in their success in bringing tens of millions of dollars in additional tourism revenue to Serbia. However, SEDP’s precise role is impossible to rigorously quantify.

In the final report, Booz Allen intends to use a combination of the quantitative data collected as discussed above, and case studies. The case studies will narrate SEDP contributions to sector change and discuss how this will influence future sector performance. Data collected up to that time will substantiate the case studies. Finally, there will be an overall quantitative program evaluation that will look at the discounted cash flow value of the project.

VI: Conclusions and Performance Risk Factors

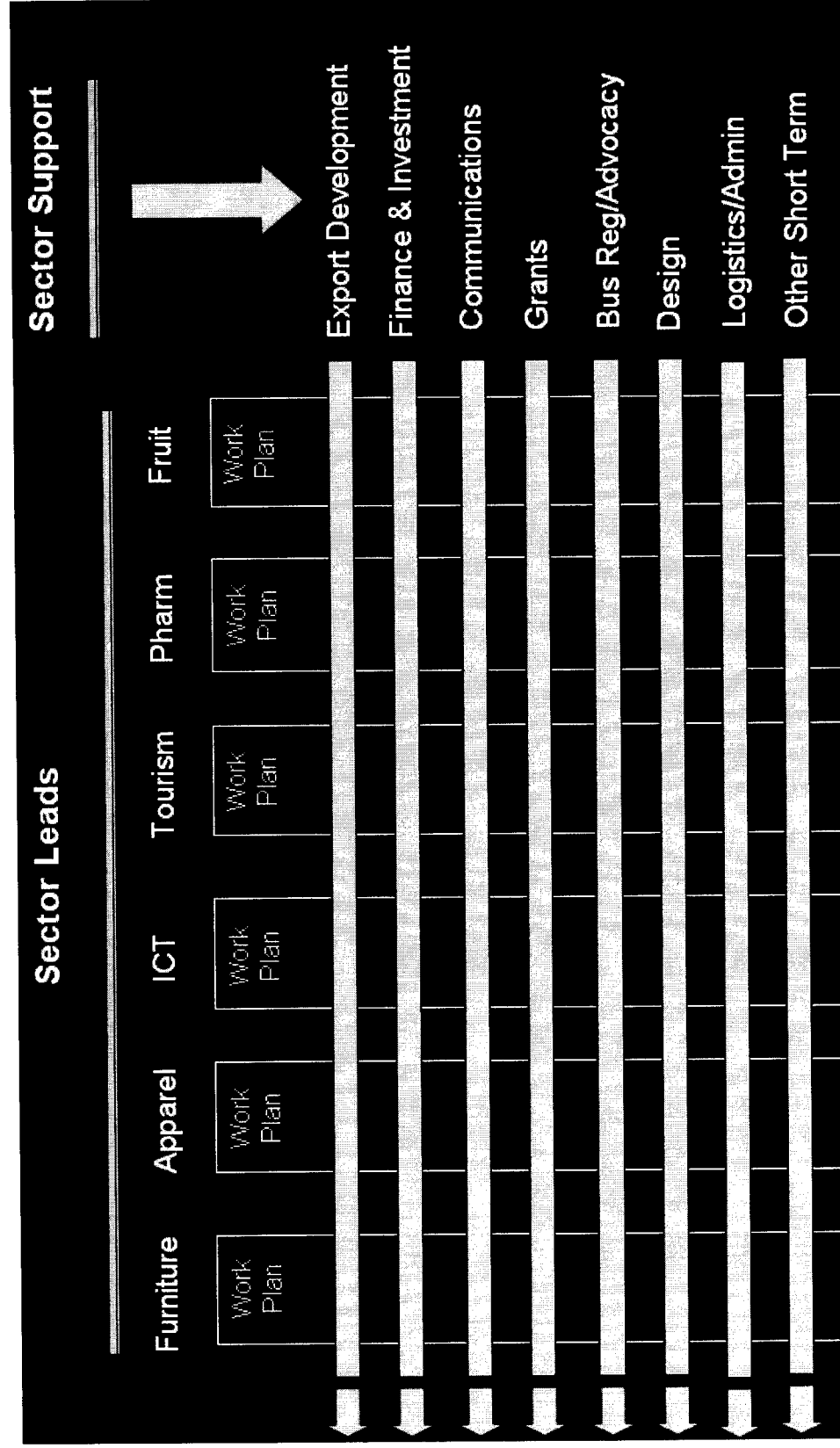
Booz Allen is on track to meet and exceed the goals set out for the activity. The exception is with the establishment of the National Competitiveness Council. However, this change and diversion of resources has been already addressed with USAID. Please refer to the first annual report for details.

By the end of the third year, SEDP will have left behind a permanent legacy of positive change. This will include: ongoing strategies in several sectors; a better image for Serbia; improved capacity of business service providers and updated university curricula that will continue to strengthen sectors; new and improved laws and regulations, and the capacity in the business community to effectively continue advocacy efforts; better business practices and techniques; permanent access to new and critical market information, and the ability to use this productively; new and increasing contacts with new markets; and, better and more efficient production techniques.

SEDP's legacy derives from the component parts of SEDP sector strategies. The degree to which these strategies are implemented prior to the end of the program will to a large extent determine SEDP's long-term impact. SEDP plans to complete the strategies to the extent possible, and to hand over further implementation to the extent possible to appropriate programs, institutions, or individuals.

However, it should be noted that real changes in company behavior and capabilities is a long-term process. In order to make the most of the foundations laid to date, it is highly recommended that USAID continue to support SEDP-initiated efforts beyond June 2006.

Appendix I: SEDP Sector Support Organization Chart



Appendix II: Locations of Grant Activities

